TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1962

No. 476

BENJAMIN BRAUNSTEIN, ET AL., PETITIONERS,

vs.

COMMISSIONER OF INTERNAL REVENUE.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR CERTIORARI FILED OCTOBER 1, 1962
CERTIORARI GRANTED DECEMBER 10, 1962

SUPREME COURT OF THE UNITED STATES

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INDEX

RECORD PRESS, PRINTERS, NEW YORK, N. Y., JANUARY 21, 1963.

[fol. 1]

IN THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

Nos. 27146, 27147 and 27148

BENJAMIN BRAUNSTEIN and DIANA BRAUNSTEIN; BENJAMIN NEISLOSS and JULIA NEISLOSS; HARRY NEISLOSS and LILLIAN NEISLOSS, Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

On appeal from a decision of the Tax Court of the United States.

APPENDIX TO PETITIONERS' BRIEF

[fol. 43]

IN THE TAX COURT OF THE UNITED STATES

STIPULATION OF FACTS

The parties, by their respective counsel, stipulate that the following facts are true and are to be considered as [fol. 44] evidence, without prejudice to the right of either party to introduce additional evidence not inconsistent with the facts stipulated herein, and without prejudice to either party to object to the relevance or materiality of any fact stipulated herein.

. . . . . .

[fol. 45]

. . . . . .

32. . . .

The basis for depreciation of buildings, shown on Springfield's income tax return, for the year ended August 31, 1950, Exhibit 8-H, is $3,919,039.29, which represents the

cost of the Springfield project, $4,069,007.82 above, less the sum of $147,354.99 deducted as interest, and $2,613.54 deducted as real estate taxes.

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[fol. 46]

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61. . . .

The basis for depreciation of buildings, shown on Hill's income tax return, for the year ended January 31, 1951, Exhibit 39-MM, is $1,822,727.42, which represents the cost of the Hill project, $1,872,834.53 above, less the sum of $48,503.88, deducted as interest, and $1,604.03 deducted as real estate taxes.

. . . . . .

[fol. 49]

. . . . . .

85. Petitioners Benjamin Braunstein, Benjamin Neisloss and Harry Neisloss also owned the stock of other corporations which secured loans which were insured by the FHA under Section 608 of the National Housing Act as amended. Attached hereto as Exhibit 72-TTT and made a part hereof is a schedule containing the names of such other corporations, the dates construction was completed, and the dates of sale of petitioners' stock in such corporations.

. . . . . .

[fol. 78]

Exhibit 72-TTT

OTHER PROJECTS IN WHICH BENJAMIN NEISLOSS, HARRY NEISLOSS AND BENJAMIN BRAUNSTEIN WERE INTERESTED

Name	*Construction Completed*	*Date of Sale*
Brookside Gardens, Inc.	January 1, 1948	Sold to One Purchaser May 15, 1953
Madison Gardens, Inc.	February 1, 1944	
Somerset Homes, Inc.	March 1, 1943	
Somerville Gardens, Inc.	September 1, 1943	
Monroe Gardens, Inc.	November 1, 1945	November 30, 1949

EXCERPT FROM JOINT EXHIBIT 4-D

CERTIFICATE OF INCORPORATION
OF
SPRINGFIELD DEVELOPMENT CO., INC.

* * * * * * *

[fol. 78a]

Eighth: The corporation shall not without prior approval of the holders of a majority of the shares of the preferred stock given either in writing or by vote at a meeting of the preferred stockholders called for that purpose (a) assign, transfer, dispose of or encumber any real or personal property, including rents, except as specifically permitted by the terms of the mortgage, (b) remodel, reconstruct, demolish or subtract from the premises constituting the project and subject to such mortgage (c) permit the occupancy of any of the dwelling accommodations of the corporation except at or below the rents fixed by the schedule of rentals provided hereinafter, (d) consolidate or merge the corporation into or with any other corporation; go into voluntary liquidation; carry into effect any plan of reorganization of the corporation; redeem or [fol. 78aa] cancel any of its shares of preferred stock, or effect any changes whatsoever in its capital stock; alter or amend the certificate of incorporation or fail to establish and maintain reserves as set forth in this certificate of incorporation.

* * * * * * *

EXCERPT FROM JOINT EXHIBIT 34-HH

CERTIFICATE OF INCORPORATION
OF
HILL DEVELOPMENT CO., INC.

* * * * * *

[fol. 78b]

Eighth: The corporation shall not without prior approval of the holders of a majority of the shares of the preferred stock, given either in writing or by vote at a

meeting of the preferred stockholders called for that purpose (a) assign, transfer, dispose of or encumber any real or personal property, including rents, except as specifically permitted by the terms of the mortgage, (b) remodel, reconstruct, demolish or subtract from the premises constituting the project and subject to such mortgage, (c) permit the occupancy of any of the dwelling accommodations of the corporation except at or below the rents fixed by the schedule of rentals provided hereinafter, (d) consolidate or merge the corporation into or with any other corporation; go into voluntary liquidation; carry into effect any [fol. 78bb] plan of reorganization of the corporation; redeem or cancel any of its shares of preferred stock, or effect any changes whatsoever in its capital stock; alter or amend the certificate of incorporation or fail to establish and maintain reserves as set forth in this certificate of incorporation.

. . . . . .

[fol. 91]

IN THE TAX COURT OF THE UNITED STATES

EXCERPTS FROM PROCEEDINGS

(From the official transcript of the testimony before the Tax Court at the hearings held on November 15, and 16, 1957, as corrected by the Joint Stipulation of the Parties filed with the Tax Court on March 10, 1958).

. . . . . .

[fol. 96] BENJAMIN NEISLOSS was called as a witness on behalf of the Petitioners, and having been first duly sworn, testified as follows:

The Clerk: State your name.

The Witness: I am Benjamin Neisloss, 110-06 70th Road, Forest Hills, New York.

Direct examination.

By Mr. Eisenstein:

Q. Mr. Neisloss, are you one of the petitioners in this case?

A. I am.

Q. Are you related to Harry Neisloss?

A. Yes, we are brothers.

Q. Are you related to Benjamin Braunstein?

A. No, sir.

Q. Is your brother Harry related to Mr. Braunstein?

A. No, sir.

Q. When did you first get to know Mr. Braunstein?

A. In 1930.

Q. What is your occupation?

A. I am in real estate.

[fol. 97] Q. What is your brother Harry's occupation?

A. Same occupation.

Q. Can you tell us what Mr. Braunstein's occupation is?

A. He is a professional architect. He also engages in real estate on occasion.

Q. How long have you been engaged in the real estate field?

A. 38 years.

Q. Where would that place the beginning now?

A. In 1919, right after the First World War.

Q. I would like you to summarize your activities in real estate between 1919 and 1930 when you say you met Mr. Braunstein.

A. My brother and I engaged in the construction of one-family homes on Long Island.

Q. Did you engage in the construction of any other type of property?

A. Yes, we did some general contract work.

Q. You indicated just now that you and your brother engaged in the construction of individual dwellings?

A. That is correct.

Q. Did you and your brother construct and sell those dwellings as individuals or corporation?

A. At that time, yes, as individuals.

Q. As individuals?

A. Prior to 1938.

Q. Do you remember more precisely where you built these homes?

A. We built them in Hollis and in Bayside, Long Island. Both places are in Long Island.

Q. How were the gains reported, as ordinary income in this or capital gain?

A. Ordinary income.

Q. Did the two of you, your brother and you, operate as a partnership?

A. Yes, just as brothers.

Q. Did you have any formal partnership arrangement?

A. No, sir.

Q. Did the two of you—well, you have indicated that you did some other kind of building in the period 1919 to 1930. Now we would like you to indicate more precisely what that building consisted of.

A. Well, in 1926, we bought a piece of property on Bell Avenue, Bayside. When I say "we", it was my brother [fol. 98] and I through a corporation, Bell Avenue Holding Corporation. They were altered and built some new stores to that.

Q. Who were the stockholders in that corporation?

A. Myself and my brother.

Q. How did you own the stock—

A. How—

Q. In what proportions?

A. 50-50, half and half.

Q. Does that Bell Corporation still own the property?

A. No, it does not, sir.

Q. What happened to it?

A. In 1929, we were victims of the depression. The tenants moved out and we deeded the property back to the mortgagee.

Q. Did you and your brother put up any other properties in the period 1919 to 1930?

A. We bought some properties I remember in Jamaica, some business property, also about 1926 some business property, stores on Jamaica Avenue.

Q. Did you buy that individually or through a corporation?

A. Corporation.

Q. What was the name of it?

A. Neisloss Brothers, Inc.

Q. Can you tell us about when it was organized?

A. It was organized about 1923, I believe.

Q. When did the corporation acquire these properties? I don't think you were very precise.

A. Are you referring to the property on Jamaica Avenue?

Q. I am referring to the properties which were acquired about 1923, I believe you said.

A. In 1923 and 1924 we bought several parcels of land in Bayside with the view of developing.

Q. When you say "we"—

A. My brother and myself.

Q. As individuals?

A. No, through the corporation.

Q. What did the corporation do with those properties?

A. They finally sold them in 1926.

Q. Did the corporation sell them?

A. The corporation sold them.

Q. Did the corporation realize a gain?

A. Some gain.

[fol. 99] Q. Did the corporation report that gain?

A. Yes, sir.

Q. Did you do any other construction work in that period?

A. You are talking now—

Q. 1919 to 1930 for persons other than yourselves?

A. Yes, we did several small construction jobs.

Q. Does Neisloss Brothers, Inc., still exist?

A. No, it does not, sir.

Q. Now, I would like you to summarize your real estate activities from 1930, the time when you met Mr. Braunstein until the beginning of World War II.

A. Well, in 1930, we met Mr. Braunstein, and he designed a group of apartments for us in Bayside. When I say "we", it was the Benhar Holding Company. He designed and we built that project in 1930, yes, 1930 to 1931.

Q. Did that project have any particular name?

A. Hawthorne Court.

Q. It was owned by Benhar Holding Corporation? What type of apartments?

A. Garden type.

Q. Who owned the stock of Benhar?

A. Myself and my brother.

Q. In equal shares?

A. Yes.

Q. What happened to that project?

A. We built that project, we sold that project in 1946.

Q. When you say you sold the project, do you mean you sold the stock or the corporation sold the assets?

A. We sold the stock.

Q. Did the stockholders report a gain on that, sir?

A. Yes, we did.

Q. Do you know whether the gain was reported as capital gain or ordinary income?

A. I believe it was capital gain.

Q. Did the Treasury ever question that?

A. No, sir.

Q. Will you tell us why the stock was sold at that time?

A. We had a good offer, we were very busy in Bayside at the time, this took some of our time, so we decided to take it.

Q. What other construction did you do from 1930 to World War II?

A. About 1934 we went back to the building business. We were out of it for a while.

[fol. 100] Q. When you say building business, what do you mean?

A. Construction. In 1934 and 1935, my brother and I purchased some individual parcels in Bayside and we built some one-family dwellings for sale. Then in 1935, the early part of 1936, we acquired a tract of land in Bayside and there we built one hundred homes, 1936, 1937 and 1938.

Q. When you say "we", you mean you built them as an individual?

A. No, we had a corporation known as the Lawrence Village Homes, Inc.

Q. Who owned that?

A. My brother and myself.

Q. In equal shares?

A. Yes.

Q. Did the Lawrence Village Corporation sell those homes?

A. Yes.

Q. Did the corporation report a gain?

A. Yes.

Q. Did it report the gain as ordinary income or capital gain?

A. Ordinary income.

Q. Did the Lawrence Village Corporation do anything else?

A. Yes. The Lawrence Village Corporation constructed a business building in Nassau County for someone else.

Q. Is the Lawrence Village Corporation still in existence?

A. No, sir, it is not.

Q. Was it liquidated?

A. Yes.

Q. About when?

A. About 1938 to 1939.

Q. Can you tell us of any other building or construction that you did?

A. During that period in 1938, we acquired a parcel of land in Jamaica. In 1936 or 1937 we acquired the land and in 1938 we built a large apartment house there. When I say "we", we formed a holding corporation in which Mr. Braunstein became one of the stockholders, together with myself and my brother.

Q. Did you own the stock in three equal shares?

A. Yes, sir.

Q. About when was that project completed?

A. It was completed in the fall of 1938.

Q. Does the corporation still own the apartment house?

A. No, it does not.

[fol. 101] Q. What happened to it?

A. It was sold in 1941.

Q. When you say it was sold, who sold it?

A. There I believe the corporation sold it.

Q. You say the corporation sold it?

A. Yes.

Q. You did not sell the stock?

A. No, sir.

Q. Did the corporation report a gain?

A. Yes, it did.

Q. Was that corporation liquidated or is it still in existence?

A. I believe it was liquidated, yes, sir.

Q. What other construction did you do?

A. Then during that period of 1938, my brother and I built a row of stores in Hollis. We formed the Hillburn Holding Corporation. There it was my brother and myself.

Q. In equal shares?

A. Yes, we built these stores in 1938.

Q. Is that property still held by the corporation?

A. No.

Q. What happened to it?

A. In 1948, yes, in 1948 we sold the stock in that corporation.

Q. Did you and your brother report a capital gain?

A. Yes, sir.

Q. Has that gain ever been questioned?

A. No, sir.

Q. Can you tell us whether there was any other building or construction from about 1930 to World War II?

A. Yes, sir, we acquired in 1938 a tract of land in Bayside. We purchased it from Wesleyan University.

Q. What year?

A. 1938, prior to the war we bought that.

Q. Where was that parcel located?

A. In Bayside, Long Island.

Q. When you say it was bought, who precisely bought it?

A. Myself, my brother and Benjamin Braunstein formed the Weeks-Woodlands, Inc.

Q. What did that corporation do with the acquired land?

A. It erected one hundred or more one-family dwellings.

Q. Were those dwellings erected for sale?

A. Yes, sir.

Q. Did the corporation sell the homes?

A. Yes, sir, it did.

[fol. 102] Q. Did the corporation report any gain on the sale?

A. Yes, sir.

Q. Was the gain reported as ordinary income or capital gain?

A. Ordinary income.

Q. Is that corporation still in existence?

A. No, sir.

Q. Has it been liquidated?

A. Liquidated after final sale.

Q. Do you recall any other real estate activity or construction activity in the period between 1930—1930 and World War II?

A. No, I do not.

Q. What is your answer?

A. I don't remember for the moment.

Q. Were any of these homes that were built by Weeks-Woodland financed through loans insured by the FHA?

A. Yes, they were.

Q. About how many?

A. About 60 per cent of them.

Q. That brings us up to World War II. I want you to summarize the real estate activities of yourself, your brother and Mr. Braunstein during the Second World War and to the end of 1947.

A. Well, when the priorities came into existence in 1942, we looked around for something to do, we went down to Virginia, then we went to the Jersey office of the FHA and we were directed to go down to Somerville, New Jersey. There was a great need for war housing down there.

Q. You mentioned an FHA office. Where was it?

A. Newark, New Jersey.

Q. Then what did you do?

A. We took options on several pieces of land down there, submitted them to the FHA. Originally it was our intention to build one-family dwellings. While we were in the FHA office, the assistant to the chief architect said, "Here is something new, warehousing, 608, look into this." He gave us some plans.

Q. Do you remember the name of this person?

A. Yes, it was Gerber. I can't remember his first name, but his last name was Gerber.

Q. What did you do?

A. Well, it attracted us. We read the literature and we [fol. 103] showed them some of the land that we were interested in. He said, "Take this, this is good. Start on this. Why don't you file an application?"

Q. Did you organize a sponsoring corporation?

A. We filed an application. We found out that we had to have a sponsoring corporation and a construction corporation. That was the understanding.

Q. Did you organize a sponsoring corporation?

A. Yes.

Q. What was the name of that?

A. 1942.

Q. What was the name?

A. Somerset Homes, Inc.

Q. Where did it build?

A. In Somerville, New Jersey.

Q. I now show you Exhibit 72-TTT, which has been attached to the stipulation of facts.

A. Yes.

Q. If you look at that exhibit, you will see it lists three 608 projects completed in 1943 and 1944 and sold in 1953.

A. Yes.

Q. A fourth 608 project completed at the end of 1947 and sold in 1953, and the fifth 608 project which was completed in 1945 and sold in 1949. When I say "sold", I mean that the stock was sold.

A. Yes.

Q. Did you, your brother Harry and Mr. Braunstein own the stock of these corporations?

A. Three of us did.

Q. Did the three of you own the stock in three equal shares?

A. Yes, sir, we did.

Q. Where were these five projects located?

A. Well, the first four were located in Somerville, New Jersey. The last one was located in Hillside, New Jersey.

Q. Will you identify the one that was in Hillside?

A. Monroe Gardens.

Q. What kind of apartments were they?

A. Garden-type apartments, two-story buildings.

Q. If you will continue to look at the exhibit, it seems to indicate that the stockholdings in Somerset, Somerville, Madison and Brookside were all sold in 1953.

A. That is correct.

Q. Were the stockholdings in each of those corporations sold separately or in one transaction?

A. They were sold as a package deal, the first four items.

Q. Did the stockholders realize any gains on the sale?

A. Yes, we did.

[fol. 104] Q. How did you record the gains on the sale of all five?

A. Capital gain.

Q. Do you know how your brother and Mr. Braunstein recorded those?

A. Same way.

Q. Has that treatment ever been questioned by the Commissioner?

A. No.

Q. Can you tell us why the stock of Monroe Gardens was sold in 1949?

A. We had a very good offer. We decided to take it.

Q. Before you sold Monroe Gardens, were you looking for a purchaser?

A. No.

Q. How was the price computed on the sale of the four Jersey projects that were sold in 1953?

A. It was computed on a basis of about one thousand dollars per apartment.

Q. Is apartment sometimes referred to as a unit?

A. Yes, one thousand dollars per unit.

Q. Did you or the other stockholders seek out the purchaser?

A. No, we did not.

Q. How did the purchaser get to you?

A. They came to us in 1953.

Q. Who were the people who came to you?

A. Kislak's office, Herman Stein and Herman Schorr, came to us.

Q. Where did they come?

A. In our office in Jamaica.

Q. At that time, was there a going market price for such projects?

A. Yes, there was.

Q. What was that going market price?

A. At that time, we understood the price to be about eight hundred dollars per apartment in 1953.

Q. I think you indicated before that you got one thousand dollars per unit?

A. That is right.

Q. Can you explain how you got one thousand dollars when the going rate was about eight hundred?

A. We were one hundred per cent occupied. We had been one hundred per cent occupied since 1943. We had never had a vacant apartment and the buildings were kept up in perfect conditions and for that reason, I believe, the purchasers recognized it.

[fol. 105] Q. Putting aside the Hill and Springfield proj-

ects which are involved immediately in this case, what other properties did you and your associates acquire?

A. During what years?

Q. From World War II until about the end of 1947. Was there any other FHA project?

A. This is exclusive of Hill and Springfield.

Q. Take us past 1947.

A. We started to negotiate for the purchase of property that was used for Mitchell Gardens in Flushing around 1948 and 1949.

Q. What kind of project did you put up in Mitchell Gardens?

A. That was a cooperative project.

Q. Under what section of FHA?

A. Section 213. May I refer to some notes here?

Q. Yes, you may. Will you tell us what other projects or developments you were engaged in putting up aside from Springfield or Hill?

A. Subsequent or prior to 1947?

Q. After World War II up to the present.

A. Well, we built—we acquired land from, land for Mitchell Gardens and built that. We acquired the land for Linden Hill which is also a cooperative project, we built that.

Q. When did you build the cooperative apartment in Linden Hills?

A. 1953 and 1954.

Q. Under what Title?

A. Also Section 213.

Q. Let us stay with Linden Hills for a while. Did you sell any stock in that project for profit?

A. No, sir.

Q. What did your income consist of?

A. Our income consisted in a profit from a construction contract.

Q. In other words, your income received as a builder?

A. Yes.

Q. Was that reported as ordinary income or capital gain?

A. Yes, that was reported as ordinary income.

Q. What other construction were you engaged in?

A. I mentioned Mitchell Gardens. We built some stores—you mean up to the present?

Q. Up to the present. I would like you to tell us pre-
[fol. 106] cisely what you did in Mitchell Gardens.

A. We erected about 1200 apartments for the cooperative corporations.

Q. What did your income consist of?

A. The profits from the construction.

Q. Were those profits reported as ordinary income?

A. Yes, sir, ordinary income.

Q. And to get this clear, when was Mitchell Gardens put up?

A. In 1951 and 1952.

Q. Can you tell us of still other construction?

A. Yes, we acquired some property on Main Street in Flushing, some store property.

Q. When did you do that?

A. That we acquired about 1947; 1947 we still own it.

Q. Did you engage in any construction there?

A. Yes, we remodeled the buildings and put up modern stores.

Q. When did you do that?

A. That was done in 1956.

Q. Can you think of any other building activities?

A. Yes, in 1955, we acquired a tract of land in Flushing and built a large apartment house.

Q. When you say "we", whom do you mean?

A. The J. L. D. Realty in which my brother and Mr. Braunstein and myself were the stockholders.

Q. Does that corporation still own that building?

A. Yes, sir, it does.

Q. How was the construction of that apartment house financed?

A. Conventional financing.

Q. You mean by private mortgage loan?

A. Yes, from a bank.

Q. Are you sure you have told us of all the construction activity you have engaged in?

A. No, we built a shopping center in Mitchell Gardens in 1952.

Q. When you say "we", whom do you mean?

A. My brother and myself and Mr. Braunstein.

Q. Do you own that individually?

A. Yes, we do. We own it as individuals. Then we also

in 1956, adjoining the shopping center, we erected a building for the U. S. Post Office and the upper floor is occupied by the Metropolitan Life Insurance Company.

[fol. 107] Q. When was that building put up?

A. 1956.

Q. Continue.

A. Now, also, Springfield Boulevard in Bayside, we erected a shopping center. That was done in 1948.

Q. When you say "we", whom do you mean?

A. That was done—that was really a contract job for the Oakland Gardens, Inc.

Q. What did your income consist of?

A. There we had no income. It was done on a reimbursement basis.

Q. Does that exhaust all your activities in real estate?

A. No, we have some vacant parcels acquired during those years. We have a vacant parcel on Northern Boulevard at Flushing which we are at the present moment intending to build an apartment house on.

Q. When you say "we have it," who has it?

A. Braunstein, Harry and myself.

Q. As individuals?

A. Right now it is owned as individuals, but it will probably be—

. . . . . .

[fol. 186]

IN THE TAX COURT OF THE UNITED STATES

EXCERPTS FROM FINDINGS OF FACT—April 11, 1961

Some of the facts and a substantial amount of evidence have been stipulated.

Benjamin Braunstein and Diana Braunstein are husband and wife, and residents of Flushing, New York. Benjamin Neisloss and Julia Neisloss were husband and wife and residents of Forest Hills, New York, during the period here pertinent. Harry Neisloss and Lillian Neisloss are husband and wife, and also residents of Forest Hills. The respective husbands and wives filed joint income tax returns for the taxable year 1959 with the collector of internal revenue for the first district of New York. The husbands are sometimes hereafter referred to as the petitioners.

Benjamin and Harry Neisloss were brothers and were active in various real estate enterprises from 1919. During the 1920's they, as individuals or through corporate organizations, built and sold one-family homes on Long Island, engaged in construction work for others, purchased several parcels of land for development, and acquired and improved commercial property which was disposed of in 1929.

During the 1930's the Neisloss brothers organized and operated Benhar Holding Corporation, Lawrence Homes, Inc., and Hillburn Holding Corporation, in which they were equal stockholders. The Benhar Holding Corporation built garden-type apartment homes in 1930 and 1931. The brothers sold their stock in that corporation in 1946. The Lawrence Village Homes, Inc., built and sold about 100 houses between 1936 and 1938, constructed a business building as a contractor, and was liquidated about 1939. The Hillburn Holding Corporation built a row of stores in 1938, and the Neisloss brothers sold their stock in that corporation in 1948.

Benjamin Braunstein is an architect, who met the Neisloss brothers in 1930, when he designed the garden apart- [fol. 187] ments of the Benhar Holding Corporation. In 1938 Braunstein and the Neisloss brothers organized and were equal stockholders of the Henshire Holding Corporation, which erected a large apartment house, sold the property in 1941, and was dissolved. In 1938 they organized Weeks-Woodlands, Inc., which built and sold about 100 houses, reported its profits as ordinary income, and was liquidated after the houses were sold.

Beginning in 1943, the three petitioners organized and were equal stockholde in seven corporations, which constructed multiple dwelling garden-type apartments located in New Jersey and in New York and financed under section 608 of the National Housing Act. After the passage of varying periods of time up to ten years from the dates of completion of these projects, petitioners sold their stock therein. The corporate names of the projects, the years of completion and the years the stock was sold, were as follows:

Project	Year of Completion	Year of Sale of Stock
Somerset Homes, Inc.	1943	1953
Somerville Gardens, Inc.	1943	1953
Madison Gardens, Inc.	1944	1953
Monroe Gardens, Inc.	1945	1949
Brookside Gardens, Inc.	1948	1953
Springfield Development Co., Inc.	1949	1950
Hill Development Co., Inc.	1949	1950

The sales were solicited by brokers acting on behalf of the buyers. The 1953 sale of stock in the four corporations was in one transaction. The 1950 sale of stock in the two corporations was in one transaction. The petitioners reported their profits on the 1949, 1950 and 1953 sales as capital gains.

• • • • • • • •

[fol. 249] Penzell and Manoochehrian undertook to sell the contract of June 8, 1950, for the purchase of the Springfield and Hill stock, but were unable to find a purchaser, and at September 8, 1950, the first date specified for closing, they exercised their privilege of postponing the closing until September 18, 1950. On the latter date, they secured another extension to September 30, 1950, by paying an additional $50,000. They were engaged at that time in negotiations with a prospective purchaser, but the sale was not consummated, whereupon Manoochehrian refused to go ahead with the closing. Due to the inability of Penzell to complete the purchase by himself, he was granted a period of several more days within which to act, and on October 5, 1950, the petitioners agreed to a further extension of thirty days.

• • • • • • • •

[fol. 250] After the sale of the stock of Springfield and Hill to Penzell and his associates, the two corporations provided utilities free to their tenants. Springfield and Hill continued as owners of the two projects.

• • • • • • • •

The petitioners each owned more than 10 percent in value of the outstanding stock of Springfield and Hill at

the time they acquired such stock and until the sale thereof on November 13, 1950. On the date of sale, such stock had been held by the petitioners for more than six months. The shares were not held as stock in trade or as property of a kind properly includible in inventory, nor were they property held primarily for sale to customers in the ordinary course of any trade or business.

After the sale of the Springfield and Hill stock, the petitioners continued to be active in real estate and the construction of projects, including apartment houses, stores and a building for the Post Office Department.

. . . . . .

[fol. 253] The distributions made by Springfield and Hill to petitioners, their shareholders, and the sale by the petitioners of their Springfield and Hill stock were attributable to circumstances which had been advisedly created by the petitioners and which were present prior to the completion of the two projects and to circumstances which reasonably could be anticipated at the time of construction, and were not attributable solely to circumstances which arose after the time of construction.

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[fol. 281]

TAX COURT OF THE UNITED STATES

Washington

Docket No. 56657

BENJAMIN BRAUNSTEIN AND DIANA BRAUNSTEIN, Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

DECISION—April 25, 1961

Pursuant to the determination of the Court, as set forth in its Findings of Fact and Opinion filed April 11, 1961, it is

ORDERED AND DECIDED: That there is a deficiency in income tax for the taxable year 1950 in the amount of $181,248.06.

Entered April 25, 1961

Bolon B. Turner, Judge.

[fol. 282]

TAX COURT OF THE UNITED STATES

Washington

Docket No. 56658

ESTATE OF BENJAMIN NEISLOSS, Deceased, JULIA H. NEISLOSS AND RUSSELL NEISLOSS, Executors, and JULIA NEISLOSS, Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

DECISION—April 25, 1961

Pursuant to the determination of the Court, as set forth in its Findings of Fact and Opinion filed April 11, 1961, it is

ORDERED AND DECIDED: That there is a deficiency in income tax for the taxable year 1950 in the amount of $156,707.14.

Entered April 25, 1961

Bolon B. Turner, Judge.

TAX COURT OF THE UNITED STATES

Washington

Docket No. 56659

HARRY NEISLOSS AND LILLIAN NEISLOSS, Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

DECISION—April 25, 1961

Pursuant to the determination of the Court, as set forth in its Findings of Fact and Opinion filed April 11, 1961, it is

ORDERED AND DECIDED: That there is a deficiency in income tax for the taxable year 1950 in the amount of $158,165.48.

Entered April 25, 1961

Bolon B. Turner, Judge.

[fol. 320]

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Nos. 256-7-8—September Term, 1961.

(Argued May 22, 1962)

Docket Nos. 27146-7-8

BENJAMIN BRAUNSTEIN and DIANA BRAUNSTEIN; Estate of BENJAMIN NEISLOSS, Deceased, JULIA NEISLOSS and RUSSELL NEISLOSS, Executors and JULIA NEISLOSS; HARRY NEISLOSS and LILLIAN NEISLOSS, Petitioners,

—v.—

COMMISSIONER OF INTERNAL REVENUE, Respondent.

OPINION—July 6, 1962

Before: Lumbard, Chief Judge, Smith and Marshall, Circuit Judges.

Petition to review a decision of the Tax Court of the United States, Turner, *Judge*, holding that two corporations were collapsible corporations under §117(m) of the Internal Revenue Code of 1939 and thus their shareholders recognized ordinary income on the sale of the stock of the corporations and the receipt of distributions from the corporations. 36 T. C. 22 (1961).

Affirmed.

[fol. 321] Thurman Arnold and Louis Eisenstein, Washington, D. C. (Julius M. Greisman and Arnold, Fortas & Porter, Washington, D. C., on the brief), for petitioners.

David O. Walter, Department of Justice, Washington, D. C. (Louis F. Oberdorfer, Assistant Attorney General, Lee A. Jackson and Harry Baum, Department of Justice, on the brief), for respondent.

LUMBARD, Chief Judge:

The taxpayers,[1] who had previously been active in constructing homes and apartment buildings, formed two corporations in 1948 for the purpose of building apartment houses in a development called Oakland Gardens in Bayside, Queens County, New York, to be financed under §608 of the National Housing Act.[2] The Federal Housing Administration (FHA) guaranteed mortgage loans to the two corporations which then built the proposed projects. Each corporation had an excess of mortgage loan funds remaining after the costs of construction had been paid. In 1950, the year following completion of construction, the three taxpayers sold their stock in both corporations at a profit and, as part of the sale transaction, received distributions which included the excess mortgage funds from the two corporations. The taxpayers reported the excess of the [fol. 322] amounts they received—both on the distributions from the corporations and on sale of their stock—over their bases in the stock and the expenses of sale as long-term capital gains of $313,854.17 each. The Commissioner asserted that the two corporations were collapsible corporations under §117(m) of the Internal Revenue Code of 1939[3]

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[1] Diana Braunstein, Julia Neisloss, and Lillian Neisloss are included in this proceeding only because they filed joint returns with their husbands, Benjamin Braunstein, Benjamin Neisloss and Harry Neisloss, repectively. The three husbands will herein be referred to as the taxpayers. Benjamin Neisloss is now deceased, his estate having been substituted as a party herein.

[2] The taxpayers formed two corporations rather than one because §608(b)(3) of the National Housing Act, 12 U. S. C. §1743(b)(3), prohibits loans beyond $5,000,000 to any one mortgagor.

[3] §117(m)—

"(1) Treatment of gain to shareholders.—Gain from the sale or exchange (whether in liquidation or otherwise) of

[fol. 323] so that the gains from the distributions and from the sale of the stock were ordinary income. In a decision which was reviewed by the full court, the Tax Court up-

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stock of a collapsible corporation, to the extent that it would be considered (but for the provisions of this subsection) as gain from the sale or exchange of a capital asset held for more than 6 months, shall, except as provided in paragraph (3), be considered as gain from the sale or exchange of property which is not a capital asset.

"(2) Definitions.—

"(A) For the purpose of this subsection, the term 'collapsible corporation' means a corporation formed or availed of principally for the manufacture, construction, or production of property, or for the holding of stock in a corporation so formed or availed of, with a view to—

"(i) the sale or exchange of stock by its shareholders (whether in liquidation or otherwise), or a distribution to its shareholders, prior to the realization by the corporation manufacturing, constructing, or producing the property of a substantial part of the net income to be derived from such property, and

"(ii) the realization by such shareholders of gain attributable to such property.

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"(3) Limitations on application of subsection.—In the case of gain realized by a shareholder upon his stock in a collapsible corporation—

"(A) this subsection shall not apply unless, at any time after the commencement of the manufacture, construction, or production of the property, such shareholder (i) owned (or was considered as owning) more than 10 per centum in value of the outstanding stock of the corporation, or (ii) owned stock which was considered as owned at such time by another shareholder who then owned (or was considered as owning) more than 10 per centum in value of the outstanding stock of the corporation;

"(B) this subsection shall not apply to the gain recognized during a taxable year unless more than 70 per centum of such gain is attributable to the property so manufactured, constructed, or produced; and

"(C) this subsection shall not apply to gain realized after the expiration of three years following the completion of such manufacture, construction, or production. • • •"

[As added by §212(a) of the Revenue Act of 1950, c. 994, 64 Stat. 906.]

held the Commissioner with one judge dissenting. 36 T. C. 22 (1961). The taxpayers appeal, and we affirm.

The Taxpayers Had the Requisite View During Construction

According to §117(m)(1)(B) of the 1939 Code, gain from the sale or exchange of stock of a "collapsible corporation," which gain, but for §117(m), would be long-term capital gain, is ordinary income. According to §117(m)(2)(A), a corporation is a "collapsible corporation" if it is formed or availed of principally for the construction of property "with a view to * * * the sale or exchange of stock by its shareholders * * * or a distribution to its shareholders, prior to the realization by the corporation * * * constructing * * * the property of a substantial part of the net income to be derived from such property" and "with a view to * * * the realization by such shareholders of gain attributable to such property." This "view" is present "whether such action [sale or exchange of the stock or distribution to shareholders] was contemplated unconditionally, conditionally, or as a recognized possibility." Treas. Reg. 111, §29.117-11(b) (1953). The "view" to such sale or distribution must exist at some time "during construction." Treas. Reg. 111, §29.117-11(b) (1953). See *Jacobson* v. *Commissioner*, 281 F. 2d 703 (3 Cir. 1960). But see *Glickman* v. *Commissioner*, 256 F. 2d 108, 110-11 (2 Cir. 1958) (dictum). Thus, if "the sale, exchange, or distribution is attributable to circum-[fol. 324] stances present at the time of * * * construction * * * the corporation shall, in the absence of compelling facts to the contrary, be considered to have been so formed or availed of." Treas. Reg. 111, §29.117-11(b) (1953). The regulations state that when a corporation's construction of property is substantial in relation to its other activities and its shareholders sell their stock or receive a distribution, thus recognizing a gain before the corporation has realized a substantial part of the net income from the property, these facts will ordinarily be sufficient, in the absence of other facts, to establish that the corporation is collapsible. Treas. Reg. 111, §29.117-11(d) (1953).

In an attempt to satisfy their burden of proof that they did not have the requisite view to sale or distribution during construction the taxpayers make two main arguments. They contend that they intended the two corporations to be repositories for the accumulation of substantial estates for their families, and thus meant the corporations to be long-term investments. They further contend that the distributions and sales were attributable to an unanticipated decline in the profitability of the two corporations—a decrease in rent income and an increase in expenses—which occurred after construction was completed. The Tax Court found that although the taxpayers may have been attempting to make profits, the facts were inconsistent with the use of the two corporations as a repository for these profits. The Tax Court also found that the facts did not bear out the taxpayers' claims that there was an unexpected decline in profitability after the completion of construction. We conclude that the Tax Court was not wrong when it found that the taxpayers had the requisite "view" prior to the completion of the two projects.[4]

[fol. 325] Although Benjamin Neisloss testified that the two corporations were intended as a long-term repository for the accumulation of a large estate, the Tax Court need not accept the unsupported testimony of an interested party. See, e.g., *Hartman* v. *Commissioner*, 296 F. 2d 726, 727-28 (2 Cir. 1961); *Payne* v. *Commissioner*, 268 F. 2d 617, 621 (5 Cir. 1959); *Cohen* v. *Commissioner*, 148 F. 2d 336 (2 Cir. 1945). Thus it is necessary for us to examine the facts to see if they lend support to the taxpayers' contention.

Benjamin and Harry Neisloss were brothers active in various real estate construction enterprises since 1919. Benjamin Braunstein is an architect who had been associated with the other two since about 1930. Beginning in 1943 the three taxpayers organized and were equal stockholders in seven corporations which constructed multiple dwelling garden-type apartments financed under §608 of the National Housing Act. After the passage of between

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[4] Although Judge Kern, the only judge to hear the oral testimony, dissented, the weight of the Tax Court's findings is not lessened because, as Judge Kern recognized, few of "the evidentiary facts are themselves in dispute," 36 TC at 88.

one and ten years from the completion of these projects, the taxpayers sold their stock in the seven corporations in 1949, 1950, and 1953. This case concerns the distribution of cash and the sale of the stock of two of these corporations.

On March 31, 1948 Springfield Development Company, Inc., and Hill Development Company, Inc., were incorporated. Each of the three taxpayers purchased ten shares of the common A stock of each corporation for $1 per share. The FHA purchased 100 shares of each corporation's preferred stock for $1 per share. Thus the two corporations' total paid-in capital was only $260. The taxpayers and their other corporations made loans to Springfield and Hill which were repaid out of the mortgage loan proceeds. Although such a nominal capitalization is not wholly incon- [fol. 326] sistent with the taxpayers' claims that they intended Springfield and Hill as a repository for the accumulation of their estates, it certainly does not lend weight to their contentions.

Previously the taxpayers had obtained a commitment from the FHA for mortgage loan insurance for the two projects, which were in fact parts of a single overall development. The FHA's total estimated cost of the projects was $6,845,804 and the total mortgage insurance commitments were $6,101,600. Both corporations entered into loan agreements with the Bank of Manhattan Company to advance the amount of the FHA mortgage insurance commitment with 4% interest.

Springfield and Hill entered into contracts with the N. B. Construction Company, Inc., of which the three taxpayers were equal shareholders, for the construction of the projects.* Although these contracts specified a lump sum consideration, in practice Springfield and Hill merely reimbursed N. B. Construction for its costs.

Construction was begun in April 1948 and the various buildings were completed between September 1948 and June 1949. The costs of construction were less than had been

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*This corporation was later succeeded by N. B. Construction Company, a partnership consisting of the three taxpayers, which completed the work. The corporation and partnership are regarded as interchangeable for purposes of this opinion.

estimated. Instead of contracting out the carpentry and plumbing work, the taxpayers had their own men do the work, saving $80,000 on carpentry and $85,000 on plumbing and heating. A decline in the cost of lumber resulted in a saving of $50,000. There were other savings amounting to nearly $90,000 in title and recording expenses and legal and organizational expenses. Furthermore, the FHA cost estimates had included $599,741 as the total builder's and architect's fees to be incurred by Springfield and Hill. N. B. [fol. 327] Construction acted as builder (in addition to doing the construction work) and Benjamin Braunstein acted as architect for the two corporations without pay,[6] thus saving nearly $600,000 more.

Thus the mortgage loan proceeds exceeded the cash expenditures in constructing the two projects by more than $150,000. These excess funds were not used to prepay a part of the corporations' large mortgage indebtedness which was costing them 4% interest. Rather, these funds were loaned interest free to the taxpayers' other construction projects. Therefore, Springfield and Hill, far from accumulating the taxpayers' estate, were incurring uncompensated interest expenses while taxpayers' other corporations used the money to make a profit.

The land on which these projects were built was not owned by Springfield and Hill. In April and May 1947 Benjamin Neisloss entered into contracts to purchase the land for $120,000. On December 15, 1947, this land was conveyed to the wives of the three taxpayers who leased it to Springfield and Hill for 99 years at a total annual rental of $23,824, a rate which would repay the original cost in five years. In the FHA project analysis it was estimated that this land would be worth $595,600, five times its purchase price, after the projects were built. Although the legality or the propriety of this transaction is not questioned, it is evident that burdening the corporations with a substantial long-term rent obligation and shifting the benefit of the increase in value of the land due to the construction thereon

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[6] Both of their contracts called for payment of fees in Common B stock. But shortly after entering these contracts both N. B. Construction and Braunstein released Springfield and Hill from their obligations to transfer the Common B stock.

from the corporations to the taxpayers' wives are not consistent with the taxpayers' claimed purpose to make Spring- [fol. 328] field and Hill long-term repositories of their increased estates.

These facts—nominal capitalization, interest free loans, and ownership of the land by the taxpayers' wives—while not necessarily inconsistent with Neisloss' testimony that the taxpayers intended to hold Springfield and Hill as long-term investments, lend little support to it. We turn now to the taxpayers' other contention, that the decision to sell was due solely to circumstances arising after construction which could not reasonably have been anticipated at the time of construction.

In making application for mortgage loan insurance the taxpayers submitted estimates of Springfield's and Hill's annual income and expenses. The FHA in making a project analysis made their own estimates. Rather than computing projected net income, the taxpayers and the FHA estimated net cash inflow, i.e., they started with estimated rent income and then deducted estimated cash expenses, estimated payments to the reserve for replacement of refrigerators, stoves, and equipment to be held by the mortgagee, and the amount of annual debt service (interest and principal payments and the cost of mortgage insurance), thus arriving at "Cash available for income taxes, corporate taxes, dividends and surplus." The estimates were as follows:

	FHA Estimate	Taxpayers' Estimate
Springfield	$53,925	$28,361
Hill	24,916	16,631
Total	$78,841	$44,992

The Tax Court found that in entering into the project the taxpayers were relying upon their own estimates and not on the FHA's higher predictions.

[fol. 329] The taxpayers claim that decreases in rental income which were not expected when construction was completed and increases in operating expenses which were also unanticipated reduced the cash available for taxes, dividends and surplus to a deficit of $20,000 per year, and that

the projects, far from being self-liquidating, would then have required the taxpayers to make annual contributions to the corporations' capital. This unexpected turn of events, rather than a previously held view to sale, the taxpayers argue, prompted them to decide to sell in late May 1950. The taxpayers compute the $20,000 annual deficit as follows:

FHA's estimated annual cash surplus	$78,841
Less: Increased real estate taxes	$80,000
Cost of garbage and rubbish removal	10,000
Cost of furnishing free gas and electricity to tenants	31,000
Decline in rental income	16,000
Increased costs of redecorating	10,000
	$97,000
Cash deficit	$18,159

After examining all these factors which the taxpayers allege contributed to the purported cash deficit of nearly [fol. 330] $20,000, we find that there was in fact no cash deficit and that the project, although not doing quite as well as the taxpayers had predicted, was earning a cash surplus. It is necessary to examine each of the factors which purportedly contributed to this nearly $20,000 annual cash deficit.

During early 1950 the New York newspapers predicted a large real estate tax increase. When the rate on Springfield's and Hill's property was fixed in June 1950 these predictions proved true. The FHA's and the taxpayers' estimates of real estate taxes and the actual 1950-51 tax in total for Springfield and Hill are as follows:

FHA's Estimates	$133,668
Taxpayers' Estimate	168,617
Actual 1950-51 real estate tax	163,663

The taxpayers, in calculating their $20,000 annual cash deficit, rely upon the fact that actual real estate taxes exceeded the FHA's estimate by $30,000. However, since the actual tax fell $5,000 short of the taxpayers' own estimate, they cannot claim that the amount of the real estate taxes was an unexpected factor.

In April 1949 the City of New York discontinued its service of garbage and rubbish removal. Thus the projects were forced to procure this service from a private contractor at a cost of approximately $8,500 a year which had not been anticipated at the time the estimates were made. The government argues that since the taxpayers were aware of this expense just before construction was completed in June 1949, to the extent that it produced a view to sell, this view was held "during construction." See *Glickman* v. *Commissioner*, 256 F. 2d 108, 111 (2 Cir. 1958). However, it has been argued that if a view to sell first [fol. 331] arose after all the decisions affecting construction had been made and construction was largely completed, the view did not arise early enough to make the corporation collapsible. McLean, Collapsible Corporations—The Statute and Regulations, 67 Harv. L. Rev. 55, 61-62 (1953). Even accepting *arguendo* the latter position, we think that the Tax Court was correct. Thus we assume that this expense of $8,500 per year arose after construction was sufficiently near completion.

Springfield and Hill had not intended to provide free gas and electricity to their tenants. However, since various competing projects did provide free utilities, Springfield and Hill had difficulty attracting and retaining tenants. Thus, by May 1950 the taxpayers decided that Springfield and Hill would have to meet competition and furnish free utilities. The cost of such a step was estimated at $31,000 per year. It appears that this expense was unexpected and might have reduced the projects' profitability unless

the rents were increased slightly. Although the Federal Housing Regulations did not permit the taxpayers to increase rents without the district director's approval, Neisloss testified that the FHA entertained applications for increases if actual operating costs exceed the estimates. Of course, the competitive situation might have prevented an increase in rents and to that extent the cost of utilities would have reduced the net cash income.

The taxpayers also claim that the vacancy rates exceeded the 7% vacancies used by the FHA and the taxpayers in making their estimates. However, during the period in question, the first half of 1950, the taxpayers had not yet begun to supply free utilities. Since Springfield's and Hill's failure to meet competition during these months was probably a major cause of their high vacancy rate and since the taxpayers had decided to supply free utilities, [fol. 332] the loss of revenues from excessive vacancies must be disregarded in predicting the projects' future net cash income. Similarly, once Springfield and Hill met competition the turnover of tenants would be reduced and the claimed redecorating costs *pro tanto* reduced. Thus the increased decorating costs and reduced rental income cannot be considered cumulatively with the cost of gas and electricity, but should be considered alternatively.

Taking the unexpected cost of utilities and garbage removal into account, the project would still have been expected to produce an annual cash surplus. The two corporations' actual results for the period before and after May 1950 bear out this conclusion. Before construction had begun the taxpayers estimated that Springfield's annual cash surplus would be $28,361 and Hill's $16,631. The projects' actual cash surplus was as follows:[7]

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[7] These figures were obtained by taking each corporations' net loss as reported on its federal income tax return, adding back non-cash depreciation expense and interest and insurance on the mortgage, and, then subtracting the FHA's estimated annual payments for debt service (including interest and principal and mortgage insurance) and the annual payments to the reserve for replacement of equipment.

	1950	1951
Springfield (Year ended Aug. 31)	$85,133	$27,351
Hill (Year ended Jan. 1)	8,978	11,596

It is difficult to believe that this small decrease, which is all the taxpayers had cause to expect, would have caused experienced real estate operators like the three taxpayers to sell their stock unless they had a previous view to its sale. Were the courts to permit any minor adversity to serve as the pretext for a previously con- [fol. 333] templated disposition, the collapsible corporation provision would indeed have a narrow scope. Thus, we must distinguish between those events which truly motivate a change in existing plans and those which merely operate as a trigger.

The taxpayers argue that this analysis is altogether too objective since the question in issue is whether the taxpayers subjectively had a view to sell during construction. However, only by determining the objective facts and attempting to ascertain their effect on the taxpayers' minds can the court assess Benjamin Neisloss' self-serving testimony that the taxpayers had no view to sell until after construction had been completed.[8]

In late May 1950 the taxpayers were approached by brokers on behalf of prospective purchasers, and in early June a contract was signed setting the price for all of Springfield's and Hill's stock at $400,000 subject to various plus and minus adjustments. Since the purchasers did not want to pay for a large amount of cash held by the corporations, Springfield and Hill increased the book value of its assets and declared dividends to the taxpayers totalling $555,000.[9] Since neither Springfield nor Hill had

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[8] McLean, Collapsible Corporations—The Statute and Regulations, 67 Harv. L. Rev. 55, 65-66 (1953); DeWind & Anthoine, Collapsible Corporations, 56 Colum. L. Rev. 475, 483 (1956).

[9] Since Springfield and Hill had loaned most of their excess cash to taxpayers' other enterprises, part of the $555,000 distribution was made by a set of bookkeeping entries rather than through an actual cash distribution.

any accumulated earnings and profits at the time of the distribution or any earnings and profits for its taxable year in which the distributions were made, the distributions were not dividends for income tax purposes. Internal [fol. 334] Revenue Code of 1939, §115(a).[10] The final sale price of all the stock was $399,702. Taxpayers reported a total long-term capital gain on their 1950 income tax returns as follows:

Distributions from Springfield and Hill	$555,000
Selling price of Springfield and Hill stock	399,702
	$954,702
Less	
Cost of stock	$ 60
Expenses of sale	13,079
	$ 13,139
Gain	$941,563

Since we do not think that the Tax Court was wrong in concluding that the taxpayers had the requisite view to sale during construction, this gain is ordinary income unless for some other reason the collapsible corporation provision does not apply.

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[10] Section 312(j) of the 1954 Code, applicable to distributions made after June 22, 1954, would have caused these distributions to be treated as dividends by increasing the corporations' earnings and profits by the amount of the excess of the FHA guaranteed loans over the adjusted basis of the buildings. However, under the 1939 Code, unless the collapsible corporation provision applies, the distributions would be treated as capital gains to the extent that they exceed the shareholder's basis. 1939 Code, §115(d); *Commissioner* v. *Gross*, 236 F. 2d 612 (2 Cir. 1956), aff'g. 23 TC 756 (1955).

[fol. 335] *More than 70% of the Gain Was Attributable to the Constructed Property*

Section 117(m) does not apply to this gain "unless more than 70 per centum of such gain is attributable to the property so * * * constructed." 1939 Code §117(m)(3)(B). The taxpayers claim that more than 30% of the gain is due to detained rental income and that such gain is not "attributable to the property so * * * constructed." Since we find that less than 30% of the gain was due to retained income, we need not decide whether the regulations which broadly interpret "gain attributable to the property," apparently to include gain attributable to retained rental income, Treas. Reg. 111, §29.117-11(c)(3), are valid. Compare *Spangler* v. *Commissioner*, 278 F. 2d 665, 670-71 (4 Cir. 1960), cert. denied, 364 U. S. 825 (1960); *Bryan* v. *Commissioner*, 281 F. 2d 238, 241 (4 Cir. 1960), cert. denied, 364 U. S. 931 (1961) (upholding the regulation), with McLean, *supra* note 8, at 79-80; DeWind & Anthoine, *supra* note 8, at 516; Anthoine, Recent Developments in Collapsible Corporations, New York University 14th Annual Institute on Federal Taxation 761, 782 (1956) (rejecting the regulation).

Springfield and Hill reported net losses on their income tax returns for the period that the taxpayers held their stock. However, in computing the amount of rental income that the two corporations accumulated, the taxpayers ask us to exclude two classes of deductions taken by the corporations on their income tax returns. But even if we agree with them as to the first, depreciation, which is a non-cash expense, the taxpayers' argument falls short. The monthly payments to the mortgagee for replacement of equipment should then be regarded as coming out of operating revenues. The replacement of existing equipment is a prerequisite to continued operations. Therefore, we reject the [fol. 336] taxpayers' claim that payments to the reserve for replacement should be treated as coming pro-rata from the excess mortgage proceeds and the accumulated rental income. And we disagree with the taxpayers as to the second, interest and real estate taxes incurred during construction. Since the corporations chose to deduct these expenses on

their income tax returns, we regard them as having been made out of operating income rather than out of the excess mortgage proceeds as the taxpayers argue. Consequently, less than 30% of the gain was due to accumulated operating income.

Section 117(m) Applies Even if Sale of the Corporate Assets Would Have Produced Capital Gain Had No Corporation Existed

The taxpayers' final argument is that §117(m) should not apply if the constructed apartment buildings would have produced capital gain on a sale by the taxpayers had no corporation been formed. We reject this argument which has, however, been recently accepted by the Fifth Circuit in *United States* v. *Ivey*, 294 F. 2d 799 (5 Cir. 1961) (2-1), rehearing denied with opinion, —— F. 2d —— (1962) (2-1).[11] The argument goes as follows:

If a taxpayer who is engaged in a trade or business constructs an asset which he holds primarily for sale in the ordinary course of his trade or business, any gain from the sale of the asset is ordinary income. 1939 Code §117 (a)(1)(A), (j)(1). Before the collapsible corporation provision was passed, a taxpayer could have formed a corporation to construct the asset and upon sale of the corporation's stock recognized capital gain instead of the ordinary [fol. 337] income he would have received had no corporation been used. Therefore, the taxpayer argues, the collapsible corporation provision was enacted to give the taxpayer ordinary income on the sale of the stock just as he would have had ordinary income on the sale of the asset, and if the taxpayer, had he constructed and sold the asset himself, would not have had ordinary income on its sale, the collapsible corporation provision should not apply.

The collapsible corporation provision as literally written applies regardless of whether the assets constructed by the corporation would have produced capital gain or ordi-

[11] See also *Honaker Drilling, Inc.* v. *Kochler*, 190 F. Supp. 287 (D. Kan. 1960), where the district court utilized this argument to find that the corporation was not availed of with the requisite view.

nary income if constructed and sold by the shareholder. Although this occasionally produces unwarranted taxation of capital gains as ordinary income, for the courts to rewrite the very complex legislation embodied in §117(m) of the 1939 Code and its successor, §341 of the 1954 Code, would produce even more confusion.[12]

The taxpayers in this case and the Fifth Circuit in *Ivey* assume that the sole purpose of the collapsible corporation provision was to deal with those cases where the shareholder would have had ordinary income if he had sold the assets himself. However, the legislative history discloses that §117(m) has another major purpose. H. R. Rep. No. 2319, 81st Cong., 2d Sess. 56-57, 97 (1950); Sen. Rep. No. 2375, 81st Cong., 2d Sess. 45, 89 (1950); H. R. Rep. No. 586, 82nd Cong., 1st Sess. 25 (1951); Sen. Rep. No. 781, 82nd Cong., 1st Sess. 33 (1951). See also DeWind & Anthoine, *supra* note 8, at 475-77 (1956); Note, Legislative Response [fol. 338] to the Collapsible Corporation, 51 Colum. L. Rev. 361-62 (1951); Bittker, *supra* note 12, at 299-300. If an individual made a movie or constructed an apartment building, income received from the rental of the movie or building would be ordinary income. Thus some taxpayers formed a corporation to make the movie or construct the apartment building and then liquidated the corporation after the movie or the building was finished. On liquidation the shareholders were taxed at capital gain rates on the difference between their basis in the stock and the fair market value of the movie or apartment building, but the shareholders' basis in the movie or apartment building was stepped-up to fair market value. The shareholders could then rent out the movie or apartment building and amortize or depreciate their stepped-up basis against rental income. Congress

[12] The commentators have generally assumed that the collapsible corporation section would be literally interpreted by the courts. See, e.g., DeWind & Anthoine, *supra* note 8, at 487, 508-09, 533; Anthoine, Collapsible Corporations; 1957 Developments, New York Univ. 16th Annual Institute on Federal Taxation 659, 661 (1958); 3B Mertens, Federal Income Taxation §22.64, p. 271; Mertens, Federal Income Taxation, Code Commentary, §341(b)(3): 1; Bittker, Federal Income Taxation of Corporations and Shareholders 309-10 (1959).

enacted §117(m) to make the shareholders' gain on liquidation ordinary income rather than capital gain. If an individual had made a movie with the intention of renting it, he would have capital gain on a subsequent sale since it would not have been held primarily for sale to customers in the ordinary course of his trade or business. Therefore, the collapsible corporation provision was intended to apply to some cases when the asset if sold by the taxpayer would have produced capital gain. However, if the *Ivey* decison is applied where a movie is made by a corporation which is then dissolved, the collapsible corporation provision will have no application to the basic fact situations which prompted its enactment.

Of course, this difficulty could be remedied by interpreting the *Ivey* decision as applicable only to sales of stock and not to liquidations. Thus, when the stock of a corporation is sold, it would not be collapsible if the underlying assets would have produced capital gain had no corporation been used, but when a corporation is liquidated, it would be [fol. 339] collapsible regardless of whether the underlying assets would have produced capital gain had no corporation been formed. However, since Congress chose to use a single statute to deal with both types of cases, it seems unwise for the courts to create the additional complexities inherent in such a two-fold interpretation. In 1958 Congress, in fact, adopted slightly different tests for collapsibility on liquidation and on sale of stock. Compare 1954 Code §341(e)(1), with 1954 Code §341(e)(2), (4). See Sen. Rep. No. 1983, 85th Cong., 2d Sess. 33-34 (1958). The multiplicity of detailed rules which this duel statutory test necessitated make it manifest that such an approach should not be effected by judicial decision.

Moreover, even as applied to the sale of stock situation, the *Ivey* decision departs from the Code's consistent framework for taxing collapsible corporations. According to the opinion denying a rehearing in *Ivey*, —— F. 2d —— (1962), if all the literal requirements of §117(m) of the 1939 Code or its successor, §341 of the 1954 Code, are satisfied, the court should disregard the shareholders' holding period for their stock and treat the shareholders as if they had owned the corporation's assets directly. Thus, any assets which

the corporation has acquired within six months and which would be capital assets in the shareholders' hands will produce short-term capital gain while those held longer than six months will produce long-term capital gain. Regardless of the theoretical wisdom of this approach, it has no basis in the collapsible corporation provision which Congress has enacted. One of the clear policy decisions embodied in §117(m) and its successor is the treatment of all or none of the gain as long-term capital gain, i.e., the refusal to split the gain between long-term capital gain and ordinary income. See Cohen, Tarleau, Surrey & Warren, A Pro-[fol. 340] posed Revision of the Federal Income Tax Treatment of the Sale of a Business Enterprise—American Law Institute Draft, 54 Colum. L. Rev. 157, 173-74, 177 (1954); *Commissioner v. Kelley*, 293 F. 2d 904, 912-13 (5 Cir. 1961).

Furthermore, regardless of how compatible with the statute the *Ivey* interpretation may have been previous to 1958, the addition of §341(e) in that year makes *Ivey's* interpretation of the collapsible corporation provision anomalous. Although §341(e) did not completely eliminate the conversion of capital gain into ordinary income by the collapsible corporation provision, it was designed to narrow the imposition of ordinary income treatment in an *Ivey* type of case where the shareholder would have recognized capital gain had he constructed and sold the asset without the use of a corporation. Sen. Rep. No. 1983, 85th Cong., 2d Sess. 31-32 (1958); Bittker, *supra* note 12, at 310-313-14. However, *Ivey* went further than §341(e) in narrowing the scope of the collapsible corporation provision.[13] Therefore, if *Ivey* is correct, either §341(e) is unnecessary or, if it is regarded as overruling *Ivey*, it expands rather than contracts the application of the collapsible corporation provision, clearly the contrary of what Congress intended. See Sen. Rep. No. 1983, 85th Cong., 2d Sess. 31-32 (1958).

Although the courts must often interpret sections of the Internal Revenue Code in light of their purposes in order,

[13] Section 431(e) was not applicable in *Ivey* since the operative facts had taken place before its enactment. Although §341(e) had been enacted before the Fifth Circuit decided *Ivey*, the court did not discuss the statutory amendment.

to carry out Congressional intent, see, e.g., *Corn Products Refining Co.* v. *Commissioner*, 350 U. S. 46, 52, 53-54 (1955); [fol. 341] *Gregory* v. *Commissioner*, 293 U. S. 465 (1935), when this would require the courts to extensively rewrite clear statutory language, the task of revision should be left to Congress, see, e.g., *Hanover Bank* v. *Commissioner*, —— U. S. —— (1962).

Affirmed.

[fol. 342]

UNITED STATES COURT OF APPEALS

SECOND CIRCUIT

BENJAMIN BRAUNSTEIN and DIANA BRAUNSTEIN, Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

JUDGMENT—July 6, 1962

Appeals from The Tax Court of the United States

This cause came on to be heard on the transcript of record from The Tax Court of the United States, and was argued by counsel.

On Consideration Whereof it is now hereby ordered, adjudged, and decreed that the order of said The Tax Court of the United States be and it hereby is affirmed.

A. Daniel Fusaro, Clerk, By Vincent A. Carlin, Chief Deputy Clerk.

[fol. 344]

UNITED STATES COURT OF APPEALS

SECOND CIRCUIT

Estate of BENJAMIN NEISLOSS, Deceased, JULIA H. NEISLOSS and RUSSEL NEISLOSS, Executors, and JULIA NEISLOSS, Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

JUDGMENT—July 6, 1962

Appeals from The Tax Court of the United States

This cause came on to be heard on the transcript of record from The Tax Court of the United States, and was argued by counsel.

On Consideration Whereof, it is now hereby ordered, adjudged, and decreed that the order of said The Tax Court of the United States be and it hereby is affirmed.

A. Daniel Fusaro, Clerk, By Vincent A. Carlin, Chief Deputy Clerk.

[fol. 346]

UNITED STATES COURT OF APPEALS

SECOND CIRCUIT

HARRY NEISLOSS and LILLIAN NEISLOSS, Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

JUDGMENT—July 6, 1962

Appeals from The Tax Court of the United States

This cause came on to be heard on the transcript of record from The Tax Court of the United States, and was argued by counsel.

On Consideration Whereof, it is now hereby ordered, adjudged, and decreed that the order of said The Tax Court of the United States be and it hereby is affirmed.

A. Daniel Fusaro, Clerk, By Vincent A. Carlin, Chief Deputy Clerk.

[fol. 348] Clerk's Certificate (omitted in printing).

[fol. 349]

SUPREME COURT OF THE UNITED STATES

No. 476—October Term, 1962

BENJAMIN BRAUNSTEIN, *et al.*, Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE.

ORDER ALLOWING CERTIORARI—Filed December 10, 1962

The petition herein for a writ of certiorari to the United States Court of Appeals for the Second Circuit is granted limited to the following question:

"1. Whether Section 117(m) of the Internal Revenue Code of 1939, which provides that gain 'from the sale or exchange * * * of stock of a collapsible corporation' is taxable as ordinary income rather than capital gain, is inapplicable in circumstances where the stockholders would have been entitled to capital-gains treatment had they conducted the enterprise in their individual capacities without utilizing a corporation."

The case is placed on the summary calendar.

And it is further ordered that the duly certified copy of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.